IN THIS ISSUE

Retirement planning

Metamorphosis into retirement

How long should you plan for?

Our services for retirees

Estate planning

Estate planning review after the SECURE Act

Tax Currents

Taxable damages

WEALTH MANAGEMENT

Orange Bank & Trust Company
Trust Services Division
Chester, New York
Mount Vernon, New York

March 2021

Metamorphosis into retirement

Retirement is an emotional transition as well as a financial transformation, a declaration of financial independence. After he retired at age 69, Washington Post financial columnist Stan Hinden wrote an occasional column for the paper called "Retirement Journal," in which he documented the decisions and surprises that he encountered. From that experience he wrote *How to Retire Happy: Everything You Need to Know About the 12 Most Important Decisions You Must Make Before You Retire* (McGraw-Hill, Fourth Edition). Hinden identified some common reasons for retiring:

- *The time is right.* After a long career, it may be time for a change, time for a rest. Even if that is the case, it's important to enter retirement with a plan for staying mentally and physically active, as well as keeping in contact with other people. We can hope that this becomes easier as more people are vaccinated and the pandemic recedes.
- *There are more compelling things to do.* Career demands may have caused the deferral of some activities or pursuits, and retirement provides the time needed for exploration and enjoyment.
- *Jobs are changing*. Especially during periods of economic transition, the needs of an employer may be evolving in ways that demand too great an adjustment by older employees. That's why many will accept an offer of early retirement during a reorganization or downsizing. Not all jobs are susceptible to working from home.

But, Hinden warns, one also should check for reasons not to retire, because they may indicate that more emotional preparation is needed before taking the retirement plunge.

- *Work is enjoyable.* The daily routine can be full of habits that are hard to break. For jobs that are not physically taxing, one can continue to be productive until age 70 and beyond.
- *Pleasures of camaraderie.* Hinden had a sharp sense of loss after he retired, a feeling that abated after he returned to work part-time on "Retirement Journal." He came to realize that he missed his workplace and his colleagues, that the office had become like a second home to him.

Continued on next page

- *No better options.* Without a good plan for retirement, one runs the risk of loneliness and depression. Being a couch potato may be temporarily relaxing, but it isn't very satisfying.

How much will you need?

Developing a realistic retirement budget is an important exercise, one that requires an examination of values as much as resources. Some people enjoy living rather modestly during retirement. But one retiree we know says, "Life is too short to drink cheap wine." The retirement budget needs to be understood from three perspectives.

- *Essential versus discretionary spending.* Which expenditures could be curtailed, even eliminated, in the event of financial reversals? Food is essential; restaurant dining is not. Is there room in the budget for savings?
- *Structural versus peripheral expenses.* Some costs are binding, not subject to modification, and failure to meet them means a structural change in retirement. If you own real property, you must pay the taxes. If you have a mortgage, you must make the payments. If you own a car, you have to pay for routine maintenance. Trips, vacations, and gifts, in contrast, are peripheral expenses.
- *Fixed versus inflation-prone costs.* Inflation has been mild in recent years, but this may not be a permanent condition. Most retirement expenses are vulnerable to inflation, while retirement income generally is fixed. The response to inflation may include cutting back on optional purchases or substituting less expensive items for those that become unaffordable.

Understand also that long, modern retirements typically include three phases:

- active retirement, filled with travel and pursuit of deferred dreams;
- passive retirement, typically beginning in the late-70s, when activities are gradually reduced; and
- final retirement, a period often marked by failing health and a need for long-term care.

A different retirement budget applies to each of these three periods.

Put us on your team

You may want to consider professional help in preparing and implementing your retirement plans. We specialize in two areas of personal financial management:

- Helping clients to *achieve* financial independence, using tax-sensitive techniques as appropriate.
- Helping clients to *maintain* financial independence by providing unbiased investment advice and trusteeship.

For specifics on how we might help you, see our asset-management specialists. ☐

How long should you plan for?

In 1900 life expectancy at birth in the United States was just 49.24 years. Thanks to dramatic strides in medical science, as well as better nutrition and less hazardous occupations, Americans born in 2017 (latest data) could look forward to living 78.6 years, to 2095, on average.

That's fine information for the youngest generation, but for those planning a retirement, the more pertinent question is, how long must my money last? The longer one lives, the longer is one's life expectancy. According to the most recent available data, the life expectancy for men age 65 in 2017 was 18.0 years (to age 83), and for women 20.6 years, over age 85. Many retirements will last for 25 or 30 years. The table to the right shows expected years of life remaining at various points during retirement. The effect of the pandemic on these figures is uncertain at this time.

Age	Men	Women
65	18.0	20.6
70	14.5	16.7
75	11.3	13.0
80	8.4	9.8
85	5.9	7.0
90	4.1	4.8

Source: National Vital Statistics Reports, Vol. 68, No. 7

Our services for retirees

You don't have to be retired to benefit from these financial services, but if you have started your retirement (or plan to soon), you should give them some careful consideration. At your request, we'd be happy to tell you more.

- **IRA rollovers.** When you receive a plan payout, you may preserve tax advantages for your retirement capital by arranging for an IRA rollover. Do you already have such an account with another firm, but feel lost in the shuffle? We'd be happy to help you move your IRA so that you can begin to benefit from our personalized investment management.
- **Personal investment accounts.** After careful study of your goals and circumstances, resources and risk tolerances, we recommend, implement, and monitor a personalized investment program for you. Because we charge annual fees linked to market value, our best interests and the best interests of our clients are linked clearly.

- **Living trusts.** The same personalized investment guidance is available to clients who wish to set up their investment programs as revocable living trusts. A trust-based financial plan doesn't impair the client's control of his or her investments, but it does offer such added benefits as probate avoidance, integration with the estate plan and financial management in the event of prolonged illness or incapacity.

© 2021 M.A. Co. All rights reserved.

Estate planning review after the SECURE Act

The Setting Every Community Up for Retirement Enhancement (SECURE) Act was enacted in December 2019. Then came the pandemic, and the CARES Act, and everyone's attention shifted. The one-year suspension of required minimum distributions from IRAs is over now, and the changes implemented by the SECURE Act are taking center stage again.

The Act included a number of liberalizations that should promote retirement savings. For example, the prohibition on contributing to a traditional IRA upon reaching age 70½ was eliminated. Required minimum distributions from IRAs and qualified retirement plans are now delayed to age 72, rather than age 70½.

To pay for any revenue loss that results from delayed tax collections, the Congress changed the rules rather drastically for inherited IRAs. Under the old rules, one who inherited a traditional or a Roth IRA was allowed to take minimum distributions from the account over his or her lifetime. For example, a 50-year-old could spread the payments out over 34.2 years. If a great-grandchild inherited the account, the payout period could be as long as 80 years! This planning strategy was known as the "stretch IRA," and it was understandably popular. To assure that the IRA was not invaded prematurely, some people paired the stretch IRA with a trust plan.

The SECURE Act largely eliminated the stretch IRA. The general rule now is that the inherited IRA assets must be distributed over the ten years following the account owner's death. Exceptions are made for these designated beneficiaries:

- a surviving spouse;
- a minor child or children;
- a disabled beneficiary;
- a chronically ill individual; and
- beneficiaries who are less than ten years younger than the account owner (such as a brother or sister).

The exception for the minor child lasts only until he or she reaches the age of majority, because then the ten-year rule kicks in. For the other categories of designated beneficiaries, the delay in distributions ends at death when a ten-year distribution must begin.

Eliminating the stretch IRA accelerates the taxes on the retirement savings, shortens the deferral period, and it also makes it more likely that the distributions will occur during the beneficiary's high-earning years instead of being delayed until retirement. If a large IRA will be a significant element of your estate, you should consider meeting with your estate planning advisors early this year to consider the effects of the SECURE Act on your planning.

Consult with your tax advisors before making any final decisions. ☐

Questions and answers

I inherited an IRA five years ago from a parent and have been taking minimum distributions over my lifetime. Does that have to change now, or do I take the rest over ten years? Good news, the new law does not affect you. Only IRAs inherited from those who died after December 31, 2019, are affected by the new law.

My children are adults, but my grandchildren are not. Can they get the benefit of waiting until they reach their majority for the ten-year rule to apply? Sorry, no. The exception only is for minor children of the account owner, not grandchildren, nieces, or nephews. These more remote relatives will need to withdraw everything from the account over ten years.

How would my estate plan be affected by converting my IRA to a Roth IRA? The Roth IRA will have to be distributed to your heirs over ten years, unless they are in one of the exempt categories noted to the left. Conversion to a Roth IRA means you are prepaying all the income taxes, so distributions to your heirs will be free from federal income taxes. They can leave the money in the Roth IRA for continued tax-free growth until that tenth year. Distributions to them from your traditional IRA will be fully taxable. However, if they are in a lower tax bracket than you are, that could be the better choice. Converting a large traditional IRA in one single year to a Roth IRA may push you into much higher tax brackets.

Taxable damages

Debra Blum went to the hospital for knee replacement surgery in August 2007. The admissions clerk directed her to sit in a wheelchair, which as it happened was broken. Blum fell to the ground and sustained significant injuries. No word on how the surgery went.

In March 2008 Blum hired an attorney to represent her in a lawsuit against the hospital for those injuries caused by the broken wheelchair. The complaint was filed in July 2010. While the complaint was pending Blum's attorney retired. A second attorney from the same firm took over the handling of the case. In September of 2011, four years after the alleged injury, the trial court granted a summary judgment motion in favor of the hospital. Blum appealed that decision on her own, without an attorney, but the Court of Appeals affirmed it. It is possible that the summary judgment was based on the tardiness of the complaint, as personal injury lawsuits generally must be brought within three years of the injury in Blum's home state.

Not satisfied with this result, Blum brought a malpractice action against her attorneys in June 2014, claiming that they had "breached a standard of care." That suit was settled one year later for $125,000. The settlement specified that it was for the firm's malpractice, that Blum's physical injuries were not caused by any action of the law firm. That language may have been included to assure coverage by the firm's malpractice insurance policy.

Blum failed to report that $125,000 on her income tax return for 2015. Damage payments for physical injuries, including damages for pain and suffering, are generally excluded from the income tax, but other damage payments, such as those to replace lost wages, are generally taxable.

The IRS noticed Blum's failure to pay income taxes on the settlement and sent a tax deficiency of $27,418 together with a penalty for inaccuracy of $5,484. Blum hired an attorney to take the matter to the Tax Court.

The IRS waived the penalty but would not budge on the taxability of the settlement proceeds. Blum argued that the proceeds were in the place of the money she would have received from the hospital but for the attorney's failures, that such a payment would have been excluded from taxation, and therefore so also should be the malpractice settlement. The Tax Court pointed out that the documentation associated with the settlement agreement made plain that the law firm was not responsible for Blum's physical injuries. As such, the payment does not meet the Tax Code requirements for a tax-free damage payment. The settlement was held to be taxable. ☐

Orange Bank & Trust Company
Trust Services Division

BROOKSIDE AVENUE
Kate Maloney, EVP & Trust Services Director
t. 845-341-5024
e. kmaloney@orangebanktrust.com
91 BROOKSIDE AVENUE • CHESTER, NY 10918

MOUNT VERNON BRANCH
Sinead Fitzsimons, VP & Senior Trust Officer
t. 914-298-9374
e. SFitzsimons@orangebanktrust.com
510 South Columbus Avenue • Mount Vernon, New York 10550

WHAT WE OFFER IS PEACE OF MIND

• Trust and Estate Administration • Special Needs Trusts
• Investment Management • IRA/401(k) Rollovers

orangebanktrust.com

Investments are not deposits, not insured by the FDIC, not guaranteed by the Bank or any Federal Government Agency and may lose value. This newsletter is being made available for educational purposes only and should not be used or construed for any other purpose. The information contained herein does not and should not be construed as an offering for advisory services. Certain information contained herein is based on or derived from information provided by independent third-party sources. Orange Bank & Trust Company believes that the sources from which such information is derived is reliable; however it cannot guarantee the accuracy of such information or the assumptions upon which it is based.